STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

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Date Amended:	**07/05/00**	Bill No:	**SB 1933**
Tax:	**Sales and Use, Property, and Special Taxes**	Author:	**Vasconcellos**
Board Position:		Related Bills:	**SB 1949 (Costa and Chesbro)**

BILL SUMMARY:

This bill would create the California Commission on Tax Policy in the New Economy to examine the impact of the Internet and other forms of electronic technology on the sales and use tax, telecommunications taxes, property taxes, and income taxes, as specified.

ANALYSIS:

Current Law:

Under current law, the California Internet Tax Freedom Act (Chapter 351 of 1998) specifies that the state may not impose or attempt to collect any tax on Internet access for three years beginning January 1, 1999. However, any existing tax, including any sales and use tax that is imposed in a uniform and nondiscriminatory manner, as specified may be imposed. This means that state and local governments may impose sales and use taxes on all Internet sales, provided that the tax and its rate are the same as that which would be imposed on transactions conducted in a more traditional manner, such as over the phone or through mail order. Sales and Use Tax Law requires persons to pay use tax, as measured by the purchase price of the property, to the Board of Equalization (BOE) on purchases of tangible personal property for use in this state from out-of-state retailers. Persons who purchase items for use in this state from out-of-state retailers *who are engaged in business in California* pay use tax to the retailer, who must remit the use tax to the BOE.

Under current federal law, a three-year moratorium was also imposed on new Internet access taxes or other levies on electronic commerce, and expires in October 2001. That legislation also created the Advisory Commission on Electronic Commerce (ACEC) to study federal, state, local, and international taxation and tariffs on transactions using the Internet and Internet access. The ACEC's 19 members include three governors, heads of several major information technology corporations, and other government and business leaders from across the nation, including Board of Equalization Chair Dean Andal. The Commission issued a report to Congress on April 3, 2000.

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Proposed Law:

This bill makes various findings and declarations regarding the rapidly changing technology and its impact on California's economy, and states "There is a need to reevaluate our entire system of tax policies and collection mechanisms in light of the new economy." This bill would add Part 18.3 (commencing with Section 38601) to Division 2 of the Revenue and Taxation Code to create the California Commission on Tax Policy in the New Economy comprised of nine voting members, five appointed by the Governor, two appointed by the President pro Tempore, and two appointed by the Speaker of the Assembly. In addition, ex officio members of the Commission would include the executive officer of the Franchise Tax Board, the chair of the BOE, the Director of Employment Development, the chair of the California Public Utilities Commission, the Director of Finance, the Controller, a public member of the California Economic Strategy Panel, and the chairs of both the Senate and Assembly Revenue and Taxation Committees.

The Commission would be charged with conducting public hearings to address Internet taxation, and study and make recommendations regarding specified elements of the California system of state and local taxes, including, but not limited to, the sales and use tax, telecommunications taxes, income taxes, and property taxes.

With respect to the sales and use tax, this bill would require the Commission to (1) examine the impact that economic transitions have had on the sales and use tax, (2) determine whether uneven treatment with respect to the method of sales, the type of commodity, and the location of the buyer and the seller may occur and the extent to which they may have led to tax-generated distortions in economic decisionmaking and disadvantages for certain businesses and economic sectors, and (3) examine the extent to which the allocation and distribution of sales and use taxes impact local decisionmaking on land use and whether alternative methods may be more appropriate.

With respect to the telecommunications tax, this bill would require the Commission to examine the status of the current telecommunications tax system, including state telecommunications surcharges, utility user charges, and franchise fees, in light of changes in the competitive and technological features of the industry. This examination should focus on the complexity, consistency, and efficiency of the system.

With respect to the property tax, this bill would require the Commission to (1) investigate the revenue repercussions for local government in assessment of real property, assuming changes in the trends of real property versus personal property utilization, (2) examine the effects of electronic commerce activity on land-based enterprises in the new economy, and (3) evaluate the impact on local economic development approaches and consider what new tools could be used.

The commission would be required to submit an interim report to the Governor and the Legislature at least 12 months from its first public meeting, and a final report with recommendations at least 24 months from its first public meeting.

This bill would be repealed on January 1, 2004.

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COMMENTS:

1. **Sponsor and purpose of the bill.** This bill is sponsored by the author in an effort to address the collection and administration of taxes in the 21st century technology-dependent economy.

2. **Amendments to this bill since our last analysis of the April 25 version are minor.** The bill as amended would add specificity regarding the Commission Members' appointments. Specifically, the bill would now require that upon appointing Members, the Governor shall take into consideration the importance of bipartisan representation of public members and designate one of the public members as Chair of the Commission. Also, the bill would now require the Senate Rules Committee, instead of the President pro Tempore, to appoint two Members, including one upon recommendation of the minority party. The Speaker of the Assembly would also now be required to appoint one of the two Members upon recommendation of the minority party.

3. **The ACEC was created by Congress to study this issue.** The ACEC obtained at least majority approval on the following concepts: (1) Extend the current moratorium on multiple and discriminatory taxation of electronic commerce for an additional five years, through 2006. (2) Prohibit taxation of digitized goods and their non-digitized counterparts to protect consumer privacy on the Internet and prevent the taxation of all services, entertainment, and information in the U.S. economy (both on the Internet and on Main Streets across America). (3) Make permanent the current moratorium on Internet access taxes, including those access taxes grandfathered under the Internet Tax Freedom Act. (4) Establish "bright line" nexus standards for American businesses engaged in interstate commerce, since the cyber economy has blurred the application of many nexus rules, and American businesses need clear and uniform tax rules and definitions before being exposed to business activity and sales and use tax collection obligations. (5) Encourage state and local governments to work with the National Conference of Commissioners on Uniform State Laws to simplify their own telecommunications and sales tax systems to ease burdens on interstate commerce. (6) Respect and protect consumer privacy in crafting any laws pertaining to online commerce generally and in imposing any tax collection and administration burdens on the Internet specifically. Their final report is available on-line at http://www.ecommercecommission.org./report.htm.

4. **Other organizations have already been formed to address tax administration in the new economy.** In addition to the ACEC, the Multistate Tax Commission (MTC), of which the BOE is a member, developed the Sales Tax Simplification Project to address sales tax simplification for all sales tax states. The minutes from these conferences are posted on the MTC website (http://www.mtc.gov). The Organization for Economic Cooperation and Development (OECD), which is comprised of the United States and 28 other countries, is actively addressing taxation issues related to e-commerce from an international perspective (http://www.oecd.org). The National Tax Association (NTA), an association of government officials, tax practitioners, business representatives, and academicians includes a Communications and Electronic Commerce Tax Project that issued its

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final report in September 1999 (http://www.ntanet.org). The Electronic Commerce Advisory Council (ECAC), which was created by Governor Pete Wilson by Executive Order W-175-98, released a report in November 1998 (http://www.e-commerce.ca.gov). And the Legislative Analysts Office issued its report, California Tax Policy and the Internet, in January 2000 (http://www.lao.ca.gov). In addition, many other states and organizations have become involved in Internet tax policy and numerous reports, with varying conclusions and recommendations, have been published on the topic.

5. **Related Legislation.** This bill is similar to SB 1949 (Costa and Chesbro), a spot bill introduced on February 24, 2000, which would require the Governor to appoint a state representative to participate in discussions with other states regarding Internet sales transactions. The Board adopted a neutral position on SB 1949. Two other bills introduced this session, SB 1377 (Haynes) and AB 2188 (Baldwin), on which the Board was neutral, would eliminate the sales tax on Internet purchases.

COST ESTIMATE:

Costs related to this bill could range anywhere from $10,000 to $50,000 for Board Members and/or staff to participate in the discussions and devise new systems for Internet sales and use tax collection and administration.

REVENUE ESTIMATE:

This bill would not impact the state's revenues. However, the following revenue summary provides information regarding the magnitude of Internet-related sales transactions and the consequential sales and use tax revenue impact.

Revenue Summary

The state, local, and transit district revenue impacts associated with California business-to-consumer Internet sales for retailers with nexus are estimated as follows:

State Impact (5%)	$42.0 million
Local Impact (2.25%)	18.9 million
Transit Impact (0.67%)	5.6 million
Total	$66.5 million

The state, local, and transit district revenue impacts associated with California business-to-business Internet sales are estimated as follows:

State Impact (5%)	$70.2 million
Local Impact (2.25%)	31.6 million
Transit Impact (0.67%)	9.4 million
Total	$111.2 million

The total state, local, and transit district sales and use tax revenue related to Internet sales transactions was approximately $178 million in 1999 (66.5 + 111.2 = 177.7).

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Qualifying Remarks

Currently, there are several private research organizations making estimates and forecasts of electronic commerce sales. There is considerable variation among them in definitions and related dollar amount estimates of U.S. electronic commerce sales for 1999. These differences are magnified in forecasts over the next several years. We also recognize that this is a very fast-changing area, and that new forecasts could be issued at any time.

While Internet commerce sales estimates vary, most researchers who have studied the subject agree that their future growth is likely to be exponential in the years ahead. Therefore, the revenue impacts estimated here for 1999 are likely to increase significantly over the next several years.

In addition to these private sector estimates, in early March the U.S. Department of Commerce issued its first quarterly estimate of retail U.S. electronic commerce sales for the fourth quarter of 1999. This figure is smaller than comparable estimates made by private firms, largely because the definitions of retail sales are different. While this is an official government data source, basing a revenue estimate on it requires as many assumptions of unknown information as using sales estimates made by private firms. Making some reasonable assumptions, using the Commerce fourth quarter figure results in an estimate of business-to-consumer annual revenue impact of approximately $64 million instead of $66.5 million for 1999. The relatively small $2.5 million difference in the two estimates is well within an expected order of magnitude for using such independent data sources, and it verifies the reasonableness of our original projection. (The $64 million estimate for California based on the U.S. Department of Commerce figure is subject to change for two reasons. First, if new information becomes available to us from private industry, some of our assumptions may change. Second, the Commerce figure itself is preliminary, and is subject to revision.)

Many assumptions needed to be made in this analysis due to unavailability of both internal and external data. The most critical assumptions are those made for U.S. and California intermediate business-to-business transactions, California nexus, and the types of goods and services being transacted using the Internet. Changes in any one of these assumptions can add or subtract several tens of millions of dollars to these estimates.

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